

UNITED STATES OF AMERICA  
POSTAL REGULATORY COMMISSION  
WASHINGTON, D.C. 20268-0001

Periodic Reporting  
(UPS Proposals One, Two, and Three)

Docket No. RM2016-2

CHAIRMAN'S INFORMATION REQUEST NO. 4

(Issued December 17, 2015)

To assist in the evaluation of its Petition requesting a change in analytical principles,<sup>1</sup> United Parcel Service, Inc. (UPS) is requested to provide written responses to the following questions. Answers should be provided no later than December 31, 2015.

1. Please confirm that UPS allocates inframarginal costs to its various products.
  - a. If confirmed, please describe the applied method for calculating and allocating these costs and identify and explain any differences between this method and the method proposed in Proposal One.
  - b. If not confirmed please:
    - i. Explain why UPS does not allocate inframarginal costs to its products.
    - ii. Explain why it is appropriate for the Postal Service to allocate inframarginal costs to its products.

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<sup>1</sup> Petition of United Parcel Service, Inc. for the Initiation of Proceedings to Make Changes to Postal Service Costing Methodologies, October 8, 2015 (Petition). To support each of its proposals, UPS also submitted the Report of Dr. Kevin Neels Concerning UPS Proposals One, Two, and Three (Report of Dr. Kevin Neels) with the Petition.

2. On page 22 of The Neels Report,<sup>2</sup> it states: “The Shapley [v]alue...provides a solution to the problem of how to attribute cost responsibility...” Please give any examples of when and how UPS has used Shapley values for allocation of costs to its various products. If there are no such examples, please indicate if UPS is planning to apply Shapley value for attributing costs.
3. On page 23 of The Neels Report, it states: “Application of the Shapley value as a cost allocation mechanism has been studied in a variety of different contexts....” Please provide an example of a regulated public utility or industry which directly applies any form of Shapley values in allocating common costs to products.
4. On page 28 of The Neels Report, it states, “[f]urthermore, the Shapley value results in a complete and exact allocation of inframarginal costs.” Please provide all available supporting documentation that Shapely values result in accurate and precise allocations of costs.

On page 20 of The Neels Report, Dr. Neels refers to the methodology developed by Dr. Charles McBride<sup>3</sup> to calculate the Postal Service’s inframarginal costs. For questions 5-7 please refer to the McBride Report.

5. On page 6, the McBride Report states that “This approach was used by the Postal Service to calculate incremental costs before FY 2007, and, with serious reservations, we adopt the same approach for calculating inframarginal costs in this paper.”
  - a. Please explain (from your point of view) the “serious reservations” regarding the adopted approach.
  - b. Please discuss which of these reservations you consider valid, and why.

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<sup>2</sup> Report of Dr. Kevin Neels Concerning UPS Proposals One, Two, and Three. October 8, 2015 (The Neels Report).

<sup>3</sup> McBride, Charles, The Calculation of Postal Inframarginal Costs., 2014 (McBride Report). The report is available at: <http://www.prc.gov/sites/default/files/reports/McBride%20092814.pdf> .

- c. Please explain why you believe these reservations do not prevent this approach from being used for calculating inframarginal costs.
- 6. On page 8, the McBride Report states that “We have serious reservations about the lack of a consistent approach as well as documentation for the criteria used by the Postal Service to decide which components would be designated as constant elasticity components and which would not.” Please discuss how these concerns affect the accuracy of Dr. Neels' calculation of inframarginal costs.
- 7. Please confirm that UPS and Dr. Neels consider constant elasticity an appropriate assumption for Postal Service costing. If not confirmed, please explain why it should be used in calculating inframarginal costs.

By the Acting Chairman.

Robert G. Taub